

Construction contractors incur Retailers' Occupation Tax liability when they engage in selling any kind of tangible personal property to purchasers without permanently affixing the tangible personal property to real estate. See 86 Ill. Adm. Code 130.1940(b)(1). (This is a GIL.)

January 7, 1999

Dear Ms. Xxxxx:

This letter is in response to your letter dated November 24, 1998. The nature of your letter and the information you have provided require that we respond with a General Information Letter which is designed to provide general information, is not a statement of Department policy and is not binding on the Department. See 86 Ill. Adm. Code 1200.120(b) and (c), enclosed.

In your letter, you have stated and made inquiry as follows:

BUSINESS is headquartered in CITY/STATE. It is an operating division of COMPANY, a STATE corporation, which has headquarters in CITY/STATE. COMPANY, is held through intermediate subsidiaries by BUSINESS, which in turn is held through an intermediate subsidiary by BUSINESS.

BUSINESS leases and sells modular space units. Modular space units are generally manufactured on a chassis. Similar to a trailer, modular space units are transported by tractor. BUSINESS does not manufacture these units, but purchases them from the manufacturer. BUSINESS maintains an inventory of these units for sale or lease to its customers. In some cases, BUSINESS will purchase a new unit from the manufacturer specifically for sale or lease to a BUSINESS customer.

BUSINESS leases and sells units to a variety of customers. The majority of BUSINESS customers are construction contractors; manufacturers; federal, state and local governmental agencies; and nonprofit and charitable organizations. These units are put to a variety of uses. The predominant use by BUSINESS customers is temporary construction site offices. Other common uses by BUSINESS customers include temporary classrooms, in-plant offices, home builder showrooms, major event facilities (e.g., political conventions, concerts, etc.), medical clinics and office space.

BUSINESS has various physical branch locations within the State of Illinois. Approximately 90% of BUSINESS' Illinois business involves the leasing of modular space units. Lease terms vary in length from a few weeks to several years. The average lease term is approximately one year. At the termination of the lease, if the unit is not sold to the lessee, the unit is returned to BUSINESS inventory where it is

prepared for lease or sale to another customer. While the amount of work needed to prepare a returned lease unit will vary by customer, the unit itself is normally easily removed from the lease location without significant damage. Approximately 10% of BUSINESS' Illinois business involves the direct sale of modular space units to customers. The types of units sold by BUSINESS are the same as those that are leased - they are built on a chassis and by their nature are mobile and easily transportable. Customers that have purchased units from BUSINESS often hire BUSINESS to coordinate the relocation of their modular space units.

Regardless of whether BUSINESS makes a lease or a sale of a modular space unit, the customer's requirements dictate the level of BUSINESS' involvement in delivering and installing the modular space unit. In many cases where a customer requests delivery and/or installation, these functions are performed by third parties at the direction of BUSINESS. Delivery may be from BUSINESS' inventory or directly from the manufacturer. Installation can be as simple as detaching the unit from the delivering trailer. In other cases, installation can involve any number of additional steps including: deflating the tires, removing the wheel assemblies, placing the unit on blocks, joining halves of multi-unit models, temporarily mounting the unit on a prepared foundation, placing skirting around the perimeter to hide the wheels, and connecting the unit to major utilities (i.e., electric, water, telephone.) Occasionally the axles and hitch are actually removed from the unit, but these features may be reattached at a later date.

This request does not deal with any type of unit that is not delivered to the customer site on its own chassis or with prefabricated building components such as wall units or roof trusses that are used in construction at a building site.

BUSINESS respectfully requests an explanation of the tax treatment for each of the four scenarios detailed below for both taxable and exempt customers.

Scenario 1

BUSINESS leases a modular unit to the customer, and plays no role whatever in securing installation of the unit. Contractually, the modular unit is to be returned to BUSINESS at the end of the lease term. The intention of the parties is that the unit remains tangible personal property as evidenced by the lessee's obligation to return the unit when the lease terminates.

Scenario 2

BUSINESS leases a modular unit to the customer and contracts with a third-party service provider the work of joining segments of the unit, the installation onto concrete slabs, and the connection to utilities. Contractually, the modular unit is to be returned to BUSINESS at the

end of the lease term. The intention of the parties to this transaction is that the unit remains tangible personal property as evidenced by the lessee's obligation to return the unit when the lease term is over.

Scenario 3

BUSINESS sells a modular unit to a customer. The contract for sale requires only that BUSINESS deliver the unit to the customer's location. The contract for sale contains no specific language regarding the length of time that the customer intends to keep the unit at the delivered site. The nature of the product, however, is that it is inherently relocatable. The inclusion of a chassis as an integral part of the unit, which is not without cost, easily distinguishes the units from simple prefabricated building parts and other structures that are far more likely to be used as part of a permanent installation.

Scenario 4

BUSINESS sells a modular unit to a customer. The contract for sale requires that BUSINESS deliver the unit to the customer's location and coordinate the installation by third party service providers. This installation would include placing a unit on a prepared foundation, securing it to the foundation, joining halves, skirting the perimeter and connecting to major utilities. Again, the contract contains no specific language regarding the length of time that the customer intends to keep the unit at the delivered site. The nature of the product, however, is that it is inherently relocatable. The inclusion of a chassis as an integral part of the unit, which is not without cost, easily distinguishes the units from simple prefabricated building parts and other structures that are far more likely to be used as part of a permanent installation.

Thank you for your time and consideration to these questions. We have enclosed a brochure so that you can visualize the type of equipment we are describing. If there is any additional information that will assist in your response, please do not hesitate to call me at ####.

Please note that the State of Illinois taxes leases differently for Retailers' Occupation Tax and Use Tax purposes than the majority of other states. For Illinois sales tax purposes, there are two types of leasing situations: true leases and conditional sales.

A true lease generally has no buy out provision at the close of the lease. If a buy out provision does exist, it must be a fair market value buy out option in order to maintain the character of the true lease. Lessors of tangible personal property under true leases in Illinois, are deemed end users of the property to be leased. See the enclosed copy of 86 Ill. Adm. Code 130.220. As end users of tangible personal property located in Illinois, lessors owe Use Tax

on their cost price of such property. No tax is imposed on rental receipts by the State of Illinois. Consequently, lessees incur no tax liability.

The above guidelines are applicable to all true leases of tangible personal property in Illinois except for automobiles leased under terms of one year or less, which are subject to the Automobile Renting Occupation and Use Tax found at 35 ILCS 155/1 et seq.

As stated above, in the case of a true lease, the lessors of the property being used in Illinois would be the parties with Use Tax obligations. The lessors would either pay their suppliers, if their suppliers are registered to collect Use Tax, or would self-assess and remit the tax to the Department. If the lessors already paid taxes in another state with respect to the acquisition of the tangible personal property, they would be exempt from Use Tax to the extent of the amount of such tax properly due and paid in such other state. See 86 Ill. Adm. Code 150.310(a)(3) enclosed.

As a general proposition, lessors who execute true leases with lessees exempt from paying sales tax on purchases of tangible personal property for their own use (e.g. exclusively religious, charitable or educational organizations or units of government) receive no pass through treatment and lessors owe Use Tax on their cost price of the rental property. The Use Tax burden remains on the lessor notwithstanding the status of the lessee. See Telco Leasing v. Alphin, 63 Ill. 2d 305 (1976); and Continental Illinois Leasing Corp. v. Department of Revenue, 108 Ill. App. 3d 583 (1st Dist. 1982).

Please note that there are some limited exceptions to the general rule prohibiting pass through treatment. There is an exemption from Retailers' Occupation Tax for any tangible personal property purchased for lease to a governmental body. See the enclosed copy of 86 Ill. Adm. Code 130.2012. The lease must have been executed or in effect at the time of purchase and must be for a period of one year or longer. The governmental body must also be recognized as tax exempt by having an active exemption number ("E-number") issued by the Illinois Department of Revenue.

Under Illinois law, lessors may not "pass through" their tax obligation on to the lessees as taxes. However, lessors and lessees may make private contractual arrangements for a reimbursement of the tax to be paid by the lessees. If lessors and lessees have made private agreements where lessees agree to reimburse lessors for the amount of the tax paid, then lessees are obligated to fulfill the terms of the private contractual agreements.

A conditional sale is usually characterized by a nominal or one dollar purchase option at the close of the lease term. Stated otherwise, if lessors are guaranteed at the time of the lease that the leased property will be sold, this transaction is considered to be a conditional sale at the outset of the transaction, thus making all receipts subject to Retailers' Occupation Tax.

Please find enclosed copies of 86 Ill. Adm. Code 130.1940 and 130.2075 regarding the tax liabilities of contractors in Illinois. The term construction contractors includes general contractors, subcontractors, and specialized contractors such as landscape contractors. The term contractor means any person

or persons who are engaged in the occupation of entering into and performing construction contracts for owners. In Illinois, construction contractors are deemed end users of tangible personal property purchased for incorporation into real property. As end users of such tangible personal property, contractors incur Use Tax liability for such purchases based upon the cost price of the tangible personal property. Therefore, any tangible personal property that general contractors or subcontractors purchase that will be permanently affixed to or incorporated into real property in this State will be subject to Use Tax. If contractors did not pay the Use Tax liability to their suppliers, contractors must self-assess their Use Tax liability and pay it directly to the Department.

In Illinois, organizations that are determined by the Department to be exclusively charitable, religious, educational, or a governmental body, are issued tax exemption identification numbers ("E" numbers). Organizations holding such numbers are exempted from paying sales tax on organizational purchases. The organization must obtain and present this number to a retailer, however, before it can make a tax-free purchase. Suppliers selling tangible personal property to such exempt organizations must retain the "E" number in order to document the exempt sale.

As stated above, contractors are generally considered to be the end users of tangible personal property they permanently incorporate into real estate and owe Use Tax upon their purchases. However, contractors who physically incorporate tangible personal property into real estate owned by holders of "E" numbers can purchase such property tax-free by providing their suppliers with the certification described in Section 130.2075(d), as well as the "E" number of the group into whose real estate that property will be incorporated. The suppliers should retain this information in order to document the tax-exempt sale.

Sales of tangible personal property to a construction contractor who does not incorporate the items into real estate owned by an exempt organization are subject to tax. Items which are purchased tax-free because of their intended incorporation into real estate owned by an exempt organization, but which are not, in fact, incorporated into real estate owned by an exempt organization, are also subject to tax.

Construction contractors incur Retailers' Occupation Tax liability when they engage in selling any kind of tangible personal property to purchasers without permanently affixing the tangible personal property to real estate. See 86 Ill. Adm. Code 130.1940(b)(1). Construction contractors can purchase such tangible personal property tax-free for resale by providing their suppliers with Certificates of Resale. See 86 Ill. Adm. Code 130.1405, enclosed.

The sales of mobile offices that you outline in your letter are analogous to a mobile home scenario. There are two types of sales of mobile homes that have different tax consequences. The first type of sale involves the selling of a mobile home without installation or incorporation into real estate. The second type of sale involves the sale of a mobile home that includes installation or incorporation into real estate.

If a retailer sells a mobile home without installation or incorporation into real estate, this sale must be reported on a transaction reporting return (Form

ST-556). In this situation, the retailer incurs Retailers' Occupation Tax and the purchaser is liable for Use Tax on the purchase price.

When a person permanently affixes or incorporates a mobile home into real estate, that person is acting as a construction contractor for purposes of Illinois tax law. See the enclosed copy of 86 Ill. Adm. Code 130.1940. A construction contractor is considered the end-user of the tangible personal property that he or she permanently attaches to real estate. The Department considers a mobile home to be permanently attached or incorporated into real estate when it is placed on a permanent foundation, all parts providing for the mobility of the structure have been removed, and it is hooked up to permanent plumbing and electrical systems. If the retailer makes a sale of a mobile home with permanent installation or incorporation into real estate as part of the sale, the retailer is liable for Use Tax based upon the retailer's cost price of the mobile home and the materials used to permanently affix the mobile home into the real estate. The retailer in this situation is considered a construction contractor and therefore is the taxable user of the property and the sale is not reported on a transaction reporting return (Form ST-556). The retailer's Use Tax liability may be reported on Form ST-1 or ST-44.

I hope this information is helpful. The Department of Revenue maintains a Web site which can be accessed at www.revenue.state.il.us. If you have further questions related to the Illinois sales tax laws, please contact the Department's Taxpayer Information Division at (217) 782-3336.

If you are not under audit and you wish to obtain a binding Private Letter Ruling regarding your factual situation, please submit all of the information set out in items 1 through 8 of the enclosed copy of Section 1200.110(b).

Very truly yours,

Melanie A. Jarvis
Associate Counsel

MAJ:msk
Enc.